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AGENDA ITEM 8b

TO: MEMBERS OF THE INVESTMENT COMMITTEE

- I. SUBJECT:** Environmental Initiatives
- II. PROGRAM:** Global Equity
- III. RECOMMENDATION:** Information
- IV. ANALYSIS:**

Executive Summary

In response to a letter submitted by California State Controller John Chiang, the Chair of the CalPERS Investment Committee directed staff to prepare this agenda item. This agenda item includes an update on the Corporate Governance Environmental Focus List Company Engagement Program. In addition, this agenda item contains two proposals for the Committee to consider that staff believes will improve the Corporate Governance Environmental Strategic Plan.

Background

Letter from California State Controller John Chiang

By letter dated February 11, 2008 (Attachment 1), California State Controller John Chiang stated that he wants to work on the CalPERS Corporate Governance Environmental Strategic Plan. State Controller Chiang stated "I would like to focus on getting companies we own to disclose the material climate risks that could significantly impact our investments." To accomplish this objective, State Controller Chiang requested two proposals to improve the CalPERS Corporate Governance Environmental Strategic Plan be placed on the agenda. The two proposals are:

1. Request that CalPERS consider amending its Corporate Governance Policy to incorporate by reference the 14 point Ceres Corporate Governance Checklist. The Checklist is attached to State Controller Chiang's letter (Attachment 1).
2. Request that CalPERS staff work with other investors in the Investor Network on Climate Risk to develop and implement a survey of public equities' investment managers regarding their ability to evaluate climate risks and opportunities of the companies in which they invest. Ceres will be asked to analyze the results of this survey and CalPERS staff will report the survey results to the Board on the best practices of investment managers so that we may consider the information in our manager reviews and requests for new managers.

Current Corporate Governance Activity

Corporate Governance Environmental Strategic Plan

The Investment Committee originally approved the Corporate Governance Environmental Strategic Plan on February 14, 2005, and directed staff to sign onto the Investor Network on Climate Risk's (INCR) Call for Action on May 16, 2005. Since that time staff has worked diligently to carry out the objective of the Environmental Strategic Plan, which is to improve environmental data transparency and timely disclosure, and undertake initiatives that address the action items of the Call for Action. On February 14, 2008, INCR released a new Action Plan which CalPERS is a signatory on and staff will continue to engage in initiatives that meet the action items in the new action plan.

In addition, staff developed and implemented an environmental company engagement initiative, including the company identification process, target companies, and engagement strategy. The objective of this initiative is to either minimize the risk or improve the stock price performance at portfolio companies in specific industries by getting them to improve their disclosure of environmental data using the Global Framework for Climate Risk Disclosure.

To date, staff has identified and been engaging four companies in the energy, transportation and utility sectors of the market to get them to adopt the Global Framework. Of the four companies, two have included elements of the Global Framework in their reporting process, including responding to the Carbon Disclosure Project's questionnaire. Staff will continue to vigorously pursue the adoption of this recommended reporting framework with the remaining two companies and is working to identify additional companies for future engagement.

Proxy Voting

During the last proxy voting season, 124 shareowner proposals were filed at portfolio companies requesting them to publish reports on Climate Change. Using CalPERS' Principles for Accountable Corporate Governance (Principles) as the basis for its proxy voting decisions, staff voted in support for each of these proposals. It is anticipated that proposals requiring similar disclosures will be filed at portfolio companies this proxy voting season and staff will continue to use the Principles as the basis for making its voting decisions.

Options for the Committee's Consideration

Staff is presenting two options for the Committee's consideration in response to State Controller Chiang's letter. Staff would move forward with implementing both options upon direction to do so by the Committee.

The two options are:

1. Amend the Corporate Responsibility section of the Global Principles of Accountable Corporate Governance to include reference to the 14 point Ceres Corporate Governance Checklist.
2. Work with other INCR investors to develop a survey of public equity investment managers ("Managers") as outlined in State Controller Chiang's letter. In addition, ask INCR to analyze the results and prepare a report on its findings from the survey responses. CalPERS, along with other INCR investors would then use the report to identify best practices amongst Managers and determine ways in which this information can be used as part of the review process for current and prospective Managers.

With regards to option #1, paragraph F.2 could be amended to read as follows:

"To ensure sustainable long-term returns, companies should provide accurate and timely disclosure of environmental risks and opportunities, through adoption of policies or objectives, such as those associated with climate change. Companies should apply the Global Framework for Climate Risk Disclosure¹² (Appendix F) when providing such disclosure. *The 14 point Ceres Climate Change Governance Checklist (Appendix G) is recommended as a tool by companies to assist in the application of the Global Framework for Climate Risk Disclosure.*"

This amendment would allow the Principles to continue to specifically recommend the use of the Global Framework while introducing the Checklist as a potentially useful mechanism for companies to achieve the desired result.

Regarding option #2, staff has been speaking with INCR who is very interested in coordinating this effort with CalPERS and other INCR investors to create a list of survey questions that would be used to solicit information from public equity Managers. In addition, staff would work with INCR to determine the best way to get the survey to Managers without duplicating efforts or burdening Managers with the receipt of multiple surveys. Managers would be directed to return the survey by a stated deadline.

Ceres would then be responsible for gathering all of the facts from the survey responses and preparing a report for INCR that summarizes both the ability and the way in which Managers evaluate climate risks and opportunities of the companies in which they invest. INCR investors will work to identify and agree on a set of best practices upon completion and review of the report. Afterwards, staff will update the Committee stating the INCR agreed upon best practices and listing ways in which staff would intend to use this information as part of its review process of both current and prospective Managers.

Next Steps

Staff seeks direction from the Investment Committee as to whether to proceed with these initiatives. Assuming direction is given to proceed, staff would present the recommended Principle revision at the next Policy Subcommittee meeting on June 16, 2008. The Investment Committee will be provided with an update on the survey during the next environmental update in fall 2008.

V. STRATEGIC PLAN:

This agenda item is consistent with the Strategic Plan: Goal IX, achieve long-term, sustainable, risk adjusted returns.

VI. RESULTS/COSTS:

Costs associated with implementing options #1 and #2 are minimal and would be absorbed by the current Investment Office budget.

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